

Internal Revenue Service
District Director
31 Hopkins Plaza
Baltimore, MD 21201

DEPARTMENT OF THE TREASURY
Southeast Key District (EP/EO)

Date: APR 19 1999

PERSON TO CONTACT:

CONTACT TELEPHONE NUMBER:

IN REPLY REFER TO:

CERTIFIED MAIL

Dear Sir or Madam,

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code and have determined that you do not qualify for tax exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

Evidence submitted shows that you were incorporated under the laws of [REDACTED]. Your purposes as stated in your Articles of Incorporation are: "Educational; Professional Services Agency. To afford the offender population and the socially disadvantaged an opportunity to acquire the skills necessary to function in mainstream society by providing psychoeducational programs utilizing materials specifically developed by [REDACTED]."

Your Bylaws state, "The mission of [REDACTED] is to work within the criminal justice system to help protect society by providing the best services available in the community to our clients. Our program resources are of the highest quality developed to help the client make a suitable adjustment, assisted by professional, caring staff."

In describing your activities, you listed several programs available to the offender and/or socially disadvantaged populations conducted at the four sites operated by the organization. These activities include the following programs: Domestic Violence Program, Substance Abuse Program, Anger Management Program, Life Skills, Teenage Programs, Parenting Program, Shoplifting/Theft Program, and a Training Division.

In describing your sources of support, you stated, "Clients pay for program attendance; [REDACTED] Department of Corrections; [REDACTED] Department of Corrections; and [REDACTED]. In describing your fundraising program, you stated, "No fundraising program per se; only stipulation that clients pay for services".

Prior to incorporating under the non-profit statute, you were incorporated as a for-profit corporation, also known as [REDACTED]. The owner of the for-profit corporation is [REDACTED] of the non-profit entity.

Included in your application was an [REDACTED], which transferred all assets and liabilities of the for-profit to the non-profit for \$[REDACTED]. This agreement also stipulated that "officer contributions" made by [REDACTED] to the for-profit corporation shall be considered a loan to the non-profit corporation and shall be payable to [REDACTED] upon demand, with annual interest not to exceed [REDACTED] percent.

Your response to our request for additional information stated:

"Since filing Form 1023, some errors were discovered as the books have been updated. Some of the 'other assets' have since been written off as 'bad debts'. [REDACTED] was originally organized in [REDACTED]. A second [REDACTED] opened in [REDACTED], a [REDACTED]. A third [REDACTED]."

[REDACTED] A fourth [REDACTED] opened in [REDACTED] corporation. These were all formed as individual entities, all owned by [REDACTED], all with the same mission and some variation on the services provided. Monies were subsequently lent to [REDACTED]. These offices have closed operations. Since then what was originally considered an asset, has been converted to a bad debt. Based on the information provided in the Profit and Loss Statement, the amount of bad debt written off as of [REDACTED]. An additional [REDACTED] was classified as bad debts in [REDACTED].

In [REDACTED] was formed. The purpose of this business, owned by [REDACTED], was to sell a comprehensive life skills program, primarily in the state [REDACTED], to departments of correction and welfare-to-work programs. [REDACTED] financed the company. As of [REDACTED], "other assets" refers to expenses incurred from this venture." As of [REDACTED] the loan balance to the [REDACTED] was \$ [REDACTED].

On the date of re-organization the not-for-profit corporation assumed substantial debt from the for-profit predecessor. These amounts included credit cards in the amount of \$ [REDACTED] and [REDACTED] from the [REDACTED] of both the for-profit and not-for-profit corporations, [REDACTED] totaling \$ [REDACTED]. These amounts are in addition to the funds loaned to [REDACTED] in the amount of \$ [REDACTED], and to the now defunct corporations in [REDACTED].

As of [REDACTED] the loan balance to [REDACTED] had increased to \$ [REDACTED] credit card debt increased to \$ [REDACTED] loans to stockholders remained at \$ [REDACTED] but a new loan from [REDACTED] in the amount of \$ [REDACTED] was included on the Balance Sheet.

The total "officer investment" as of [REDACTED] is \$ [REDACTED] based on the transaction listing by account provided. This includes \$ [REDACTED] associated with [REDACTED] \$ [REDACTED] associated with the now closed operation [REDACTED] and \$ [REDACTED] to the [REDACTED]. All of this investment by an officer occurred involved the various corporations, before [REDACTED] re-organized as a not-for-profit. These amounts should be reflected as capital contributions to the corporations. It is also noted that there is no written loan document as of the date the organization filed Form 1023.

As of [REDACTED] the loan balance to [REDACTED] had increased to \$ [REDACTED] credit card debt increased to \$ [REDACTED], loans to stockholders remained at \$ [REDACTED], and the loan from [REDACTED] increased to \$ [REDACTED].

To qualify for exemption under Internal Revenue Code section 501(c)(3) an organization must be organized and operated exclusively for charitable, educational or religious purposes, and no part of the net earning shall inure to the benefit of any private shareholder or individual. The Income Tax Regulations (Regs.) section 1.501(c)(3) explain what is meant by the organizational and operational tests.

Regs. 1.501(c)(3)-1(a) Organizational and Operational Tests. (1) In order to be exempt as an organization described in section 501(c)(3) it must be organized and operated exclusively for one or more purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Regs. 1.501(c)(3)-1(b)(1)(i) provide that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) limit the purposes of such organization to one or more exempt purposes; and
- (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Regs. 1.501(c)(3)-1(c)(2) Distribution of earnings. An organization is not organized and operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Regs. 1.501(c)(3)-1(d)(1)(ii) Exempt Purposes. An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his

[REDACTED]

family, shareholders of the organization, or persons controlled either directly or indirectly, by such private interests.

The organization was created as a for-profit corporation and subsequently re-organized as a not-for-profit corporation in [REDACTED] only when it became apparent that it would be very difficult to obtain government funding as a for-profit.

The operation of the newly re-organized corporation is still intertwined with the operation of the other for-profit corporations created by [REDACTED]. There are loans to and from the for-profit corporations. The not-for-profit corporation is operating as though it is another for-profit created by [REDACTED] and has been used to finance the activities of [REDACTED]. The organization has not established that it is organized and operated exclusively for Code section 501(c)(3) purposes and not for the private benefit of its founder.

[REDACTED] is not organized and operated exclusively for charitable, educational or religious purposes as defined in Code section 501(c)(3).

Accordingly, this organization is not exempt from Federal income tax as a charitable organization described in section 501(c)(3).

You are not relieved of the requirement to file Federal income tax returns.

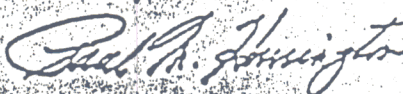
Contributions to your organization are not deductible by donors under section 170(c)(2) of the Code.

If you do not agree with our determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if you request, at any mutually convenient district office. If someone who is not one of your principal officers will represent you, he or she will need to file a power of attorney or tax information authorization with us. If you do not appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination on this matter.

If you do not appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination letter in this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust all administrative remedies. Section 7428(b)(2) of the Code provides, in part, that, "A declaratory judgment or decree under this section shall not be issued in any of the proceeding unless the Tax Court, U.S. Court of Claims or District Court of the U.S. for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

Sincerely,



Paul M. Harrington
District Director

Enclosure: Publication 892